

# Enhancing Economic Growth Through Federal Personal Income Tax Reform

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## Executive Summary

The COVID-19 pandemic is behind us, but economic growth in Canada remains sluggish. Low economic growth results in several negative consequences for Canadians, including slower growth in employment, incomes, and living standards.

The future trajectory of Canada's economy, however, is not set in stone. Reforming the federal personal income tax (PIT) system through tax reductions while eliminating several tax credits is one policy option that could boost economic growth and improve incentives for entrepreneurs.

Meaningful changes to the PIT system have not been made in decades and are much overdue. The last fundamental reform to the system originated in 1987 with the publication of a major White Paper on taxation, and most of the changes that have taken place in the years since have been incremental and ad hoc. For instance, the top federal PIT rate was increased in 2016 from 29.0 to 33.0 percent. The government also lowered the second-lowest PIT rate from 22.0 to 20.5 percent, while eliminating several tax credits. Meanwhile, major tax reforms have been avoided or ignored.

Canada has been uncompetitive on tax rates with jurisdictions in the United States for decades, but the federal government's decision to increase its top PIT rate to 33.0 percent in 2016 has caused Canada's tax competitiveness to deteriorate significantly in recent years. In 2023, out of 61 Canadian and US jurisdictions, Canadian provinces occupied the top eight positions for the highest top combined marginal PIT rates. The other two provinces, Alberta and Saskatchewan, placed tenth and fifteenth, respectively. The ten provinces also have some of the highest combined marginal PIT rates at incomes of CA\$75,000 and CA\$150,000.

Canada's tax system has become increasingly complex over time and now consumes considerable resources in the form of compliance costs. One main source of this increasing complexity is tax expenditures—the proliferation of credits, deductions, and other special preferences. The Trudeau government eliminated a number of tax credits in 2016, but 149 federal PIT expenditures remain.

Many of these tax expenditures do little to improve economic incentives and spur growth. The layering of tax expenditures for certain population groups or activities distorts the tax system and creates biases against individuals who are not eligible for these

preferences. This paper identifies 49 different federal tax expenditures that should be eliminated, which would give the federal government \$32.1 billion to lower marginal PIT rates.

The revenue from the tax expenditures that should be eliminated and a modest reduction in government spending would provide the federal government an opportunity to remove the three middle income tax rates of 20.5 percent, 26.0 percent, and 29.0 percent. Moreover, the government could reduce the top marginal PIT rate from 33.0 to 29.0 percent and leave the bracket's current income threshold as is. With these tax changes, Canadian provinces would be significantly more tax competitive with their counterparts in the United States, which, in turn, would provide a much-needed boost to the Canadian economy by improving incentives to work, save, and invest.

These changes would establish a new tax landscape with just two federal PIT rates. Nearly all Canadians would face a marginal tax rate of 15.0 percent, while top earners would pay a marginal tax rate of 29.0 percent. Altogether, this package of tax reductions, fully implemented, would cost \$37.7 billion.

Canada's tax system is in serious need of reform. It is now characterized by increasing complexity, numerous inefficient tax expenditures, and waning competitiveness. A broad-based reduction in marginal tax rates would improve economic incentives and tax efficiency, enhance growth, simplify the tax system, and increase living standards for Canadians.

## Introduction

The COVID-19 pandemic is behind us, but Canada's economic growth remains sluggish. The federal government's 2023 fall economic statement anticipates average real growth of gross domestic product (GDP) of 1.7 percent over the next five years (Canada, Department of Finance, 2023a). This is significantly lower than the experience of 2010 to 2019, when real GDP grew, on average, by 2.3 percent annually (Statistics Canada, 2023). Weaker projected economic growth in the coming years is especially concerning given that, as a recent study found, per-person economic growth from 2013 to 2022 (the most recent 10-year period) was at its lowest point since the 1930s (Cross, 2023). Low economic growth results in several negative consequences for Canadians, including slower growth in employment, incomes, and living standards (Lammam et al., 2015).

The future trajectory of Canada's economy, however, is not set in stone. Reforming the federal personal income tax (PIT) system through tax reductions while eliminating several tax credits is one policy option that could boost economic growth and improve incentives for entrepreneurs. Meaningful changes to the PIT system have not been made in decades and are quite overdue.

In 2016, the federal government increased its top PIT rate from 29.0 to 33.0 percent (Young, 2016). It also reduced the second-lowest PIT rate from 22.0 to 20.5 percent, but removed several tax credits that increased personal income taxes, on net, for many Canadian families. In fact, as a result of the income tax changes, 61 percent of middle-income families paid more in taxes than before (Palacios et al., 2022).

Another issue is that Canada remains uncompetitive with the United States on PIT rates at incomes of \$50,000, \$75,000, \$150,000, and \$300,000 (in Canadian dollars) (Hill et al., 2020). Canada is also markedly uncompetitive on top statutory tax rates compared with those of both its southern neighbour and other advanced economies of the Organisation for Economic Co-operation and Development (OECD) (Hill et al., 2020). These relatively high tax rates discourage individuals from working, investing, saving, and engaging in productive entrepreneurial activity. They also hinder Canada's ability to attract and retain highly skilled workers, entrepreneurs, and business owners.

A 2013 study found empirical evidence that marginal tax rates play a substantial role in influencing such individual behaviour as choosing to work more hours during a certain period of time, accepting a new job that involves higher pay but a longer commute, or investing in one's education (Murphy et al., 2013). While there is some debate among



economists about the extent to which marginal tax rates influence individual decisions, there is little dispute about the adverse economic effects of high and increasing marginal tax rates.

This paper studies the opportunity for personal income tax reform at the federal level in Canada. The first section provides a brief history of federal PIT reform. The second section outlines the basic details of the current PIT system, including tax rates and income thresholds. The third section reviews the current set of tax expenditures in the PIT system. The final section examines a policy option to flatten and lower the federal marginal tax rate structure. This tax policy option would represent a major step toward improving Canada's tax competitiveness while spurring economic growth, entrepreneurship, and innovation.

## A Brief History of Personal Income Tax Reform

There have been several changes to the federal personal income tax system in recent decades, but most of these changes have been incremental and ad hoc. Meanwhile, major tax reforms have been avoided or ignored. In fact, the last fundamental reform to the PIT system originated in 1987 with the publication of a major White Paper on taxation (Canada, Department of Finance, 1987). The White Paper included the recommendation of a series of comprehensive tax reforms, such as a goods and services tax (GST)—eventually implemented in 1991—as well as a call for “lower tax rates and a broader, fairer tax base” (Canada, Department of Finance, 1987: 10). The federal government ultimately followed these recommendations by lowering the top marginal tax rate from 34.0 to 29.0 percent, reducing the number of tax brackets from ten to three, and eliminating some exemptions and deductions to broaden the tax base.

Since then, federal governments of different political stripes have argued for reducing marginal tax rates, based on the potential of lower rates to enhance economic growth. The Chrétien government, in its 2000 budget and economic statements, introduced the most prominent changes to the tax system since 1987. Among the various measures, the government eliminated the deficit reduction surtax, reduced the middle tax rate from 26.0 to 24.0 percent, lowered the first bracket tax rate from 17.0 to 16.0 percent, further reduced the middle tax rate to 22.0 percent, and in 2001 introduced a fourth tax bracket (Canada, Department of Finance, 2000a, 2000b). One of the most important tax measures was ending “bracket creep” by restoring the full indexation of all tax brackets and the basic personal amount (Lammam et al., 2015).<sup>1</sup>

Support for tax reductions continued under successive federal governments. In 2005, then-prime minister Paul Martin asserted that “lower personal taxes would... provide greater rewards and incentives for middle- and high-income Canadians to work, save, and invest” (Canada, Department of Finance, 2005: 130). In turn, Prime Minister Stephen Harper also stressed that “Canada needs lower personal income tax rates to encourage more Canadians to realize their full potential” (Canada, Department of Finance, 2006: 46). Despite their support for tax reductions, however, neither prime minister’s government made significant changes to the PIT rate structure during their tenures.

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1 Bracket creep refers to a situation in which inflation pushes an individual’s income into a higher tax bracket. The result is an increase in income tax but no increase in real purchasing power.

In 2016, the Trudeau government increased the top federal PIT rate from 29.0 to 33.0 percent and lowered the second-lowest PIT rate from 22.0 to 20.5 percent, while eliminating several tax credits (Canada, Department of Finance, 2015).<sup>2</sup> These changes, again, were incremental and mostly ad hoc. Further changes to the federal personal income tax system have since stalled.

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2 The Trudeau government made these tax changes before the United States adopted a significant package of tax reforms for individuals and businesses in 2017 (Michel, 2017).

## Current Federal Personal Income Tax Rates

Canada’s current federal personal income tax system consists of five tax brackets (table 1a shows taxable income thresholds and PIT rates). In 2023, individual Canadians paid a tax rate of 15 percent on the portion of their taxable income equivalent to \$53,359 or less (Canada Revenue Agency, 2023).<sup>3</sup> In the second-lowest personal income bracket, marginal income between \$53,359 and \$106,717 is taxed at a rate of 20.5 percent. In the third bracket, the tax rate for marginal income between \$106,717 and \$165,430 is 26 percent; in the fourth bracket the tax rate is 29 percent for marginal income between \$165,430 and \$235,675; and in the fifth bracket, marginal income over \$235,675 is taxed at a rate of 33 percent.<sup>4</sup> For comparison, table 1b shows federal personal income tax rates in the United States.

Canada has been uncompetitive on tax rates with jurisdictions in the United States for decades, but the federal government’s decision in 2016 to increase the top PIT rate from 29.0 to 33.0 percent has meant a significant deterioration in the country’s tax competitiveness in recent years. Out of 61 Canadian and US jurisdictions in 2023, Canadian provinces occupy

Table 1a: Federal personal income tax rates, by income threshold, Canada, 2023

Income threshold	Tax Rates
\$15,000-\$53,359	15.0%
\$53,360-\$106,717	20.5%
\$106,718-\$165,430	26.0%
\$165,431-\$235,675	29.0%
\$235,676+	33.0%

Source: Canada Revenue Agency (2023).

Table 1b: Federal personal income tax rates, by income threshold, United States, 2023

Income threshold	Tax Rates
\$0-\$11,000	10.0%
\$11,001-\$44,725	12.0%
\$44,726-\$95,375	22.0%
\$95,376-\$182,100	24.0%
\$182,101-231,250	32.0%
\$231,251-\$578,125	35.0%
\$578,126+	37.0%

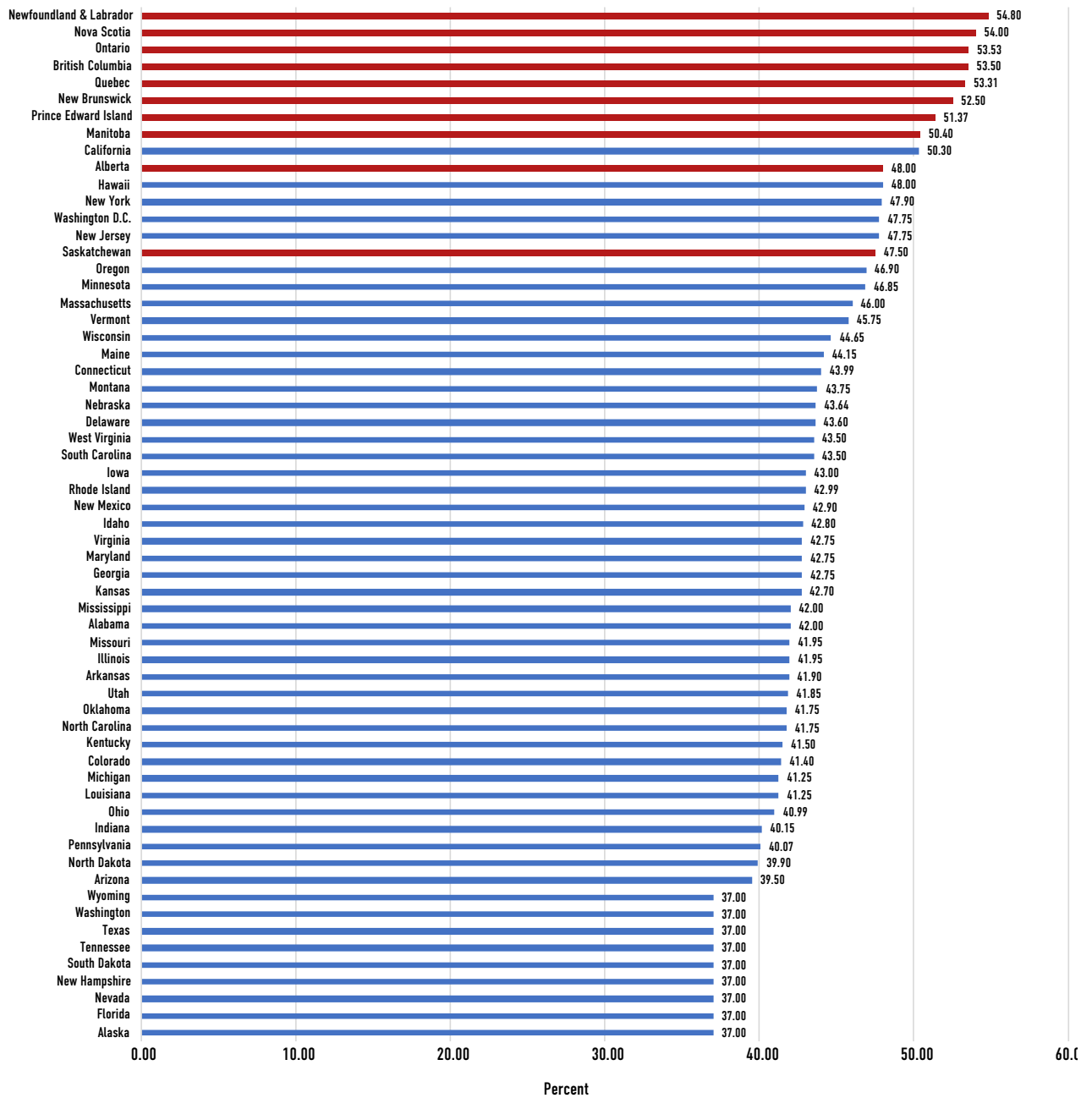
Source: Durante (2022).

3 The basic personal amount gives all individuals with taxable income below a threshold—\$15,000 in 2023—a full reduction from federal income tax and a partial reduction to taxpayers with taxable income above the threshold.

4 Another issue is the federal government’s overreliance on PITs to generate revenue. In 2023, personal income taxes are projected to equal 46.8 percent of total federal revenue (Canada, Department of Finance, 2023a).

the top eight positions for highest combined marginal PIT rates (figure 1). Moreover, Alberta and Saskatchewan, which rank outside the top eight, place tenth and fifteenth, respectively. As well, the ten Canadian provinces have some of the highest combined marginal PIT rates, at CA\$75,000, and CA\$150,000 of income (figures 2 and 3).

**Figure 1: Top combined statutory marginal income tax rate, Canadian provinces and US states, 2023**

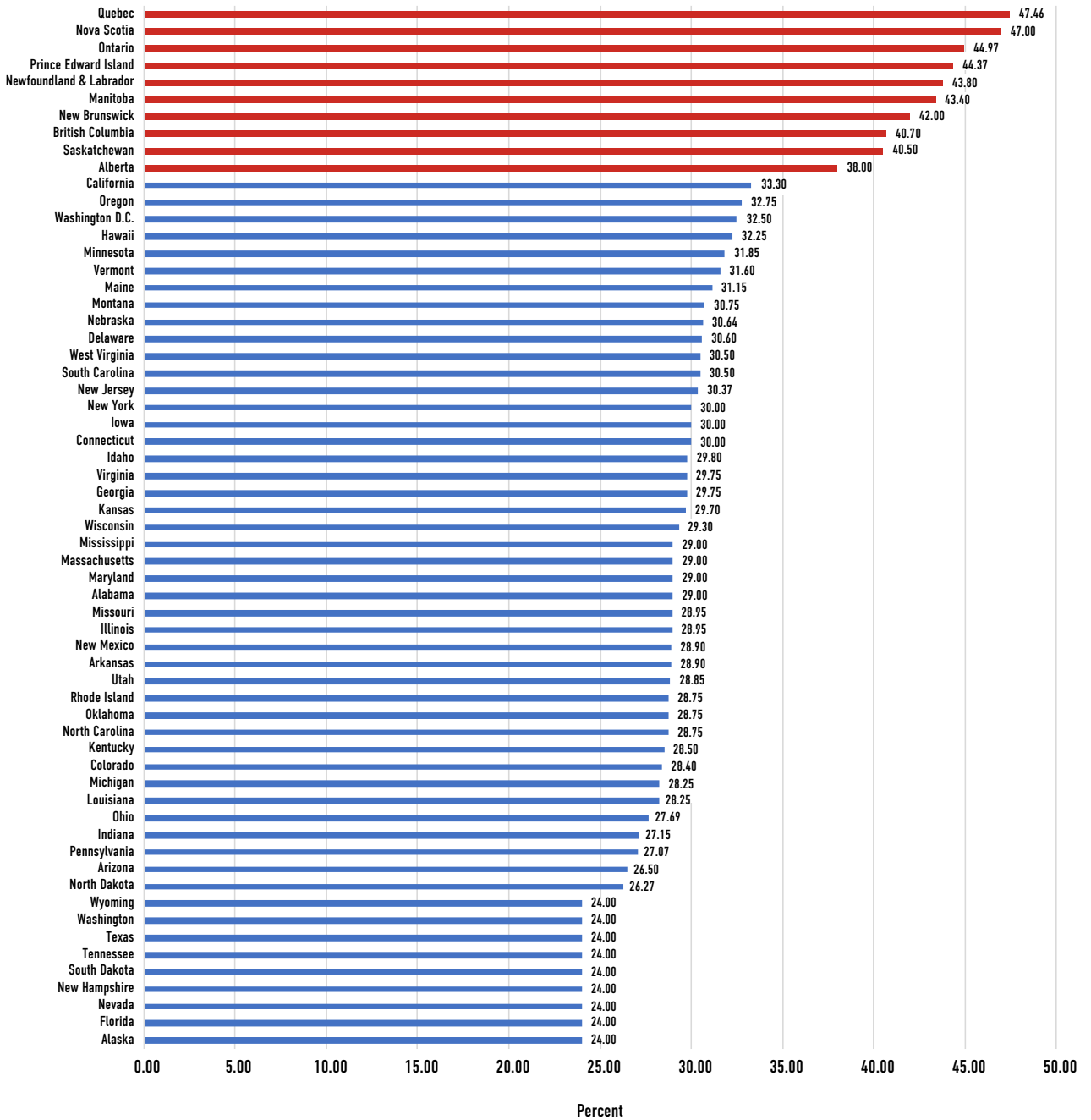


Notes:

1) Personal income tax rates include surtaxes where applicable. Quebec’s tax rate is adjusted for the federal abatement. (2) For US states, local income taxes are excluded.

Sources: Canada Revenue Agency (2023); Durante (2022); Revenu Québec (2023); Vermeer (2023); authors’ calculations.

**Figure 2: Combined statutory marginal income tax rate at CA\$150,000, Canadian provinces and US states, 2023**

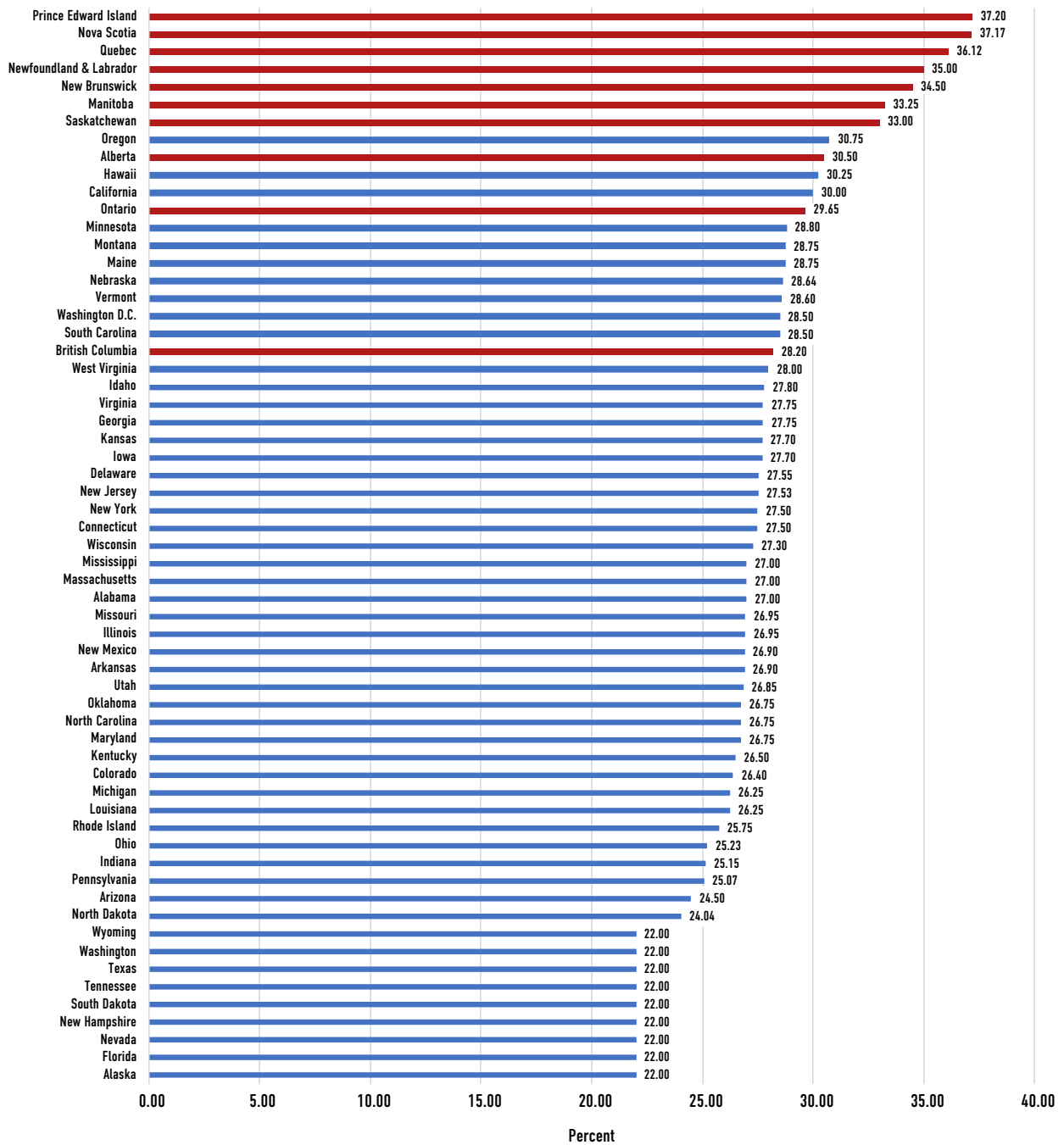


Notes:

- 1) Personal income tax rates include surtaxes where applicable. Quebec's tax rate is adjusted for the federal abatement.
- 2) For US states, local income taxes are excluded.
- 3) The 2023 exchange rate for converting Canadian dollars to US dollars is 1.3475 (average quarterly projection, TD Economics, 2023). At this rate, CA\$150,000 is equivalent to US\$111,317.

Sources: Canada Revenue Agency (2023); Durante (2023); Revenu Québec (2023); TD Economics (2023); Vermeer (2023); authors' calculations.

**Figure 3: Combined statutory marginal income tax rate at CA\$75,000, Canadian provinces and US states, 2023**



Notes:

- 1) Personal income tax rates include surtaxes where applicable. Quebec's tax rate is adjusted for the federal abatement.
- 2) For US states, local income taxes are excluded.
- 3) The 2023 exchange rate for converting Canadian dollars to US dollars is 1.3475 (average quarterly projection, TD Economics, 2023). At this rate, CA\$75,000 is equivalent to US\$55,659.

Sources: Canada Revenue Agency (2023); Durante (2023); Revenu Québec (2023); TD Economics (2023); Vermeer (2023); authors' calculations.

## Tax Expenditures

Canada's tax system has become increasingly complex over time and now consumes considerable resources in the form of compliance costs. A main source of this increasing complexity is tax expenditures: the proliferation of credits, deductions, and other special preferences that are a core feature of the current federal PIT system. Although tax expenditures can reduce an individual's tax bill, they add to the cost of compliance because claiming a tax credit or deduction requires keeping records, ensuring eligibility, additional time to organize and file taxes, and perhaps hiring an accountant to ensure that no tax benefits are missed. Another issue is that the value added to the economy from tax expenditures is low because they provide few behavioural incentives related to boosting work, savings, investment, or entrepreneurship (Lammam et al., 2015).

Poschmann et al. (2019) found that the number of federal PIT expenditures increased by 32 percent from 1996 to 2016, while the dollar value (adjusted for inflation) of tax expenditures grew by 55 percent over the same period. This notable increase in tax expenditures is important because the economic literature shows that they subsidize behaviour that taxpayers likely would have undertaken anyway (Lammam et al., 2015). Although in 2016 the Trudeau government did eliminate a number of tax credits, 149 federal PIT expenditures remain in 2023 (Canada, Department of Finance, 2023b).

In addition, tax expenditures narrow the tax base. This means that marginal tax rates in Canada are higher than they otherwise would be if the tax base were broader. The result is an inefficient and uncompetitive personal income tax system.

Canada's PIT system currently has many deductions and credits. Many of these tax expenditures do little to improve economic incentives and spur growth. Certain tax expenditures already have considerable overlap and redundancies or limited effectiveness in delivering on their specified policy goals. For instance, the expansion to the Guaranteed Income Supplement and recent enhancements to the Canada Pension Plan have augmented the Age Credit, which helps low-income seniors cover their cost of living. Credits or deductions related to work-related expenses, union and professional dues, and the Canada Employment Credit also offer questionable benefits. The layering of tax expenditures for certain population groups or activities distorts the tax system and creates bias against specific individuals who are not eligible for these special preferences.

Eliminating a large number of tax expenditures would allow the federal government to broaden the tax base and lower marginal tax rates to simplify the tax system. A framework



Table 2: Tax expenditures available for elimination, 2023 (\$ millions)

Area of tax expenditure	Simple cost estimate
<b>Total</b>	<b>32,131</b>
<b>Employment</b>	<b>11,681</b>
Canada Employment Credit	2,985
Non-taxation of benefits from private health and dental plans	3,835
Deduction of other employment expenses	1,240
Child Care Expense Deduction	1,000
Deduction of union and professional dues	1,300
Employee stock option deduction	1,075
Partial deduction of and partial input tax credits for meals and entertainment	120
Moving expense deduction	120
Apprentice vehicle mechanics' tools deduction	4
Deduction for tradespeople's tool expenses	2
Employee benefit plans	n.a.
<b>Age and Retirement</b>	<b>7,935</b>
Age Credit	4,680
Pension income splitting	1,895
Pension Income Credit	1,360
<b>Medical and Disability</b>	<b>4,873</b>
Medical Expense Tax Credit	2,050
Disability Tax Credit	1,600
Non-taxation of workers' compensation benefits	850
Canada Caregiver Credit	255
Non-taxation of investment income on certain amounts received as damages in respect of personal injury or death	n.a.
Registered Disability Savings Plans	115
Disability supports deduction	3
<b>Charity and Volunteering</b>	<b>3,667</b>
Charitable Donation Tax Credit	3,510
Non-taxation of capital gains on donations of publicly listed securities	125
Non-taxation of capital gains on donations of cultural property	4
Search and Rescue Volunteers Tax Credit	2
Tax-free amount for emergency services volunteers	3
Volunteer Firefighters Tax Credit	20
Non-taxation of capital gains on donations of ecologically sensitive land	3
<b>Education</b>	<b>2,837</b>
Tuition Tax Credit	2,135
Exemption of scholarship, fellowship and bursary income	455
Registered Education Savings Plans	180
Student Loan Interest Credit	55
Teacher and Early Childhood Educator School Supply Tax Credit	10
Deduction for tuition assistance for adult basic education	2

Table 2: Tax expenditures available for elimination, 2023 (\$ millions)

Area of tax expenditure	Simple cost estimate
Small Business, Fishing, Farming, and Logging	2
Tax treatment of farm savings accounts (AgrilInvest and Agri-Quebec)	n.a.
Logging Tax Credit	2
Miscellaneous	662
Northern Residents Deduction	265
First-Time Home Buyers' Tax Credit	270
Deduction for clergy residence	100
Political Contribution Tax Credit	25
Adoption Expense Tax Credit	2
Deduction for certain contributions by individuals who have taken vows of perpetual poverty	n.a.
Deductibility of expenses by employed artists	S
Deduction for self-employed artists	n.a.
Targeted investment	474
Flow-through share deductions	250
Labour-Sponsored Venture Capital Corporations Credit	175
Critical Mineral Exploration Tax Credit	50
Reclassification of expenses under flow-through shares	-1
Non-taxation of provincial assistance for venture investments in small businesses	n.a.

## Notes:

S = small (less than \$2.5 million); n.a. = data are not available to support a meaningful estimate or projection.

Source: Canada, Department of Finance (2023b).

for which tax expenditures should be removed is provided by Lammam et al. (2015), who evaluate each credit or deduction based on whether it deviates from or is inconsistent with a consumption-based tax system.<sup>5</sup> Here, we adopt the same methodology, and analyze the current tax expenditures in the Department of Finance's latest report (Canada, Department of Finance, 2023b). Based on this analysis, we identify 49 different federal tax credits, deductions, and special preferences (see table 2) that should be eliminated. In total, the elimination of these 49 tax expenditures would provide the federal government with \$32.1 billion in 2023 alone in order to lower marginal personal income tax rates.

5 The key difference between an income tax and a consumption-based tax is the tax treatment of income from capital (i.e. invested savings). A consumption-based tax excludes income from capital or applies a preferential tax rate on capital income or provisions for different forms of tax sheltering (i.e. RRSPs). The premise is that the tax paid on an individual's income should be the same on a present value basis regardless of whether the earnings are consumed immediately or deferred in the form of savings or investment. See Lammam et al. (2015) for more details.

## Federal Personal Income Tax Reform

The federal government needs to make significant reforms to the tax system, particularly for personal income taxes. Recent research demonstrates that personal income taxes cause significantly more economic harm per dollar of government revenue raised than do more efficient forms of taxation, such as sales taxes (Dahlby and Ferede, 2022). Crucially, reducing PIT rates would help drive higher rates of economic growth and increase the size of the tax base over time.

Federal tax reform will be difficult to implement, however, because the government faces daunting fiscal challenges, including growing spending, persistent deficits, significant debt accumulation, and rising debt interest costs. If Ottawa were to reduce PIT rates without other policy changes, the federal deficit would increase meaningfully and compound these challenges. To acknowledge these obstacles, we briefly discuss policy options the government could consider undertaking to ensure tax reforms do not enlarge the budget deficit. These changes include reducing tax expenditures in the tax code and reducing federal government spending.

Cost estimates of the effect of tax changes often make conservative assumptions that lowering tax rates have no impact on economic growth and therefore drive no increase in the size of the tax base. These estimates are referred to as “static,” rather than “dynamic,” because they take the size of the tax base as a given. Static models, therefore, do not account for any behavioural changes that arise from tax changes. Lammam et al. (2015) note that the majority of economists “agree that tax reductions can have dynamic effects.” This means that tax cuts can boost economic activity and generate additional revenue to offset a portion of the initial revenue loss.

One US study found that a one percentage point cut in the average PIT rate raises real GDP per capita by 1.4 percent in the first quarter of the reform and by up to 1.8 percent after three quarters (Mertens and Ravn, 2012). A more recent US study finds that a one percentage point decrease in marginal income tax rates increases real GDP by 0.78 percent by the third year after the tax change (Mertens and Olea, 2018).

Our analysis uses static assumptions due to the difficulty of calculating and isolating the dynamic effects of tax reductions. We acknowledge that our estimates overstate costs, as they do not account for behavioural changes in the economy stemming from tax cuts. Cost estimates of revenue losses are projected based on simple calculations of the size

of the tax reduction. The cost estimates are produced using Statistics Canada’s tax-and-transfer model.<sup>6</sup>

A simple pro-growth option would be for the federal government to implement a two-rate system that eliminates inefficient, non-consumption-based tax expenditures and uses the resulting revenues to flatten the marginal rate structure. Removing the three middle income tax rates of 20.5 percent, 26.0 percent, and 29.0 percent would reduce both the number of brackets and the system’s complexity, while improving economic incentives. The federal government should also reverse the increase in the top marginal tax rate introduced in 2016, lowering the rate from 33.0 to 29.0 percent.

These tax changes would establish a new tax landscape with just two federal PIT rates. Nearly all Canadians would face a marginal tax rate of 15.0 percent, while top earners would pay a marginal tax rate of 29.0 percent. Altogether, this package of tax reductions, fully implemented, would cost \$37.7 billion (in static terms). Table 3 compares the proposed new federal tax rate structure and taxable income thresholds with existing rates and thresholds.<sup>7</sup>

Table 3: Proposed federal personal income tax rates, by income threshold

Income threshold	Current tax rate	New tax rate
\$15,000-\$53,359	15.0%	15.0%
\$53,360-\$106,717	20.5%	15.0%
\$106,718-\$165,430	26.0%	15.0%
\$165,431-\$235,675	29.0%	15.0%
\$235,676+	33.0%	29.0%

Sources: Canada Revenue Agency (2023); authors’ calculations.

The \$32.1 billion in tax expenditures identified for elimination provides meaningful fiscal room to make these changes to the federal PIT rate structure. The result would be a personal income tax system that is more competitive and that enhances economic growth. Although the elimination of \$32.1 billion in tax expenditures would not cover the entire cost of the package of tax reductions we outline, one policy option to account for the remaining \$5.6 billion of suggested tax relief is to implement an equivalent amount of

6 Calculations based on Statistics Canada’s Social Policy Simulation Database and Model (SPSD/M), version 30.0.

7 The net income distribution of the tax changes ultimately would depend on what, if any, other steps the government took in concert with this type of tax reform policy. However, the benefits of the reforms likely would be greater for highly skilled workers, professionals, and entrepreneurs than for other income groups. If the government wanted to adjust the distributional effect, it could consider augmenting remaining tax expenditures for low-income households.

federal program spending reductions. For instance, a \$5.6 billion cut would represent a 1.2 percent reduction in federal program spending in fiscal year 2023/24 (Canada, Department of Finance, 2023a). To provide context, inflation-adjusted federal program spending is projected to grow by \$47.0 billion (or 11.7 percent) between 2019/20 and 2023/24 (Canada, Department of Finance, 2023a). Moreover, federal per-person spending (adjusted for inflation) increased from \$9,064 to \$11,395, or 25.7 percent, between 2014/15 and 2023/24. Given this significant recent increase in federal spending, a 1.2 percent reduction in annual spending is a relatively modest change.

Implementing a two-rate PIT system would markedly improve Canada's tax competitiveness with the United States. Such a move would bring Newfoundland and Labrador's top combined PIT rate to within a half-percentage point of California's (figure 4). With this reform package, the number of Canadian jurisdictions in the top 10 highest combined marginal PIT rates would decline from eight to six.<sup>8</sup> All but two provinces would have top combined marginal PIT rates below 50.0 percent, while Alberta and Saskatchewan would fall from tenth and fifteenth to twentieth and twenty-fifth places, respectively.

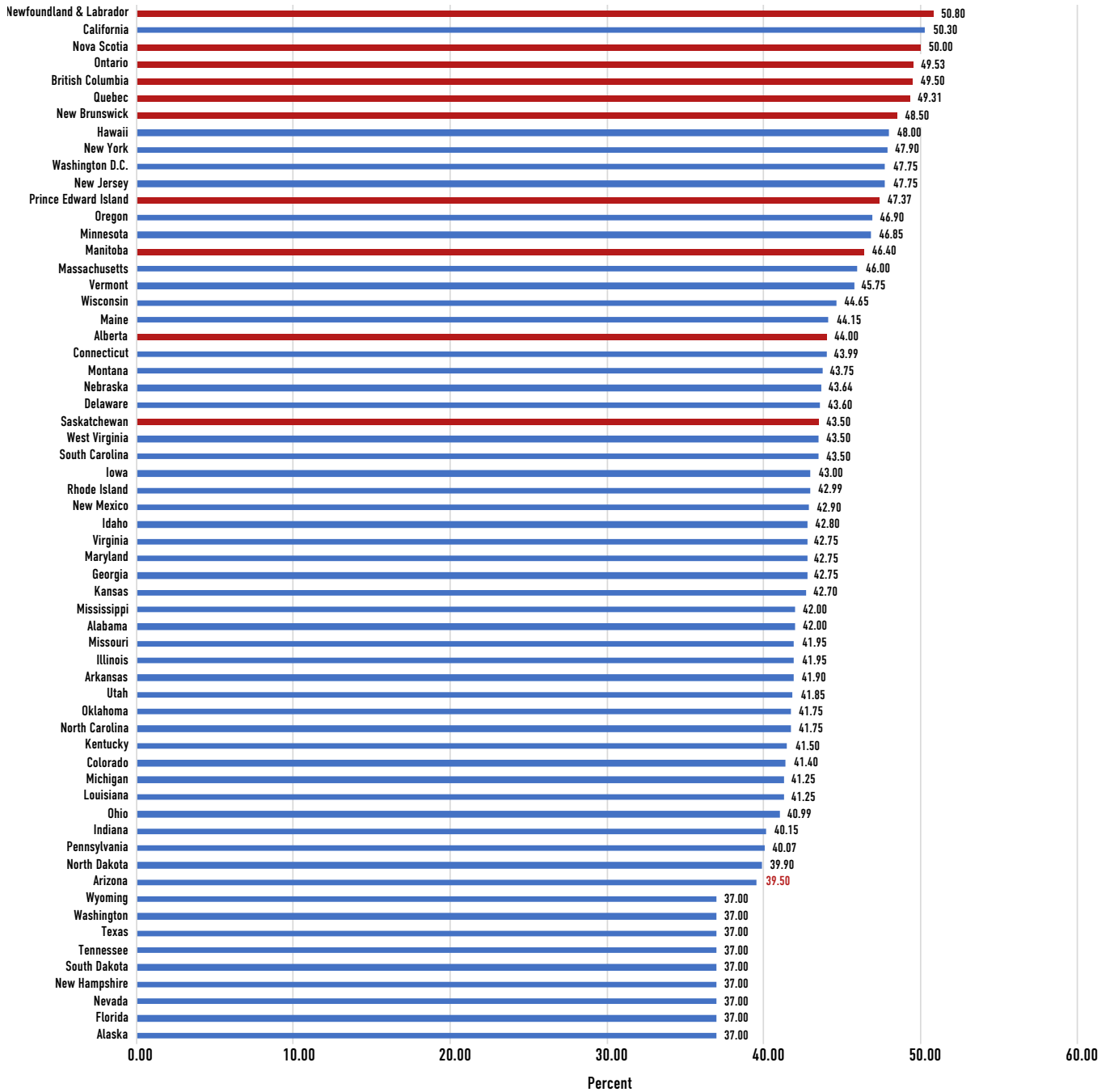
Improving tax competitiveness in this manner would increase economic growth and improve incentives for entrepreneurs, professionals, and business owners. One study estimates that a one percentage point cut in the federal top PIT rate would lead to an increase in the private employment rate of about 0.25 percent in the year following the tax rate cut (Ferede, 2021). Put differently, with a reduction in the top marginal PIT rate from 33.0 to 29.0 percent, the private sector would create about 110,000 jobs in the first year after the tax change.

Canada's tax competitiveness would also improve dramatically at the CA\$150,000 and CA\$75,000 income brackets (figures 5 and 6). At the higher bracket, six provinces, rather than all ten, would be in the top ten jurisdictions with the highest combined marginal tax rates, with Alberta dropping to twelfth-lowest among the 61 Canadian and US jurisdictions. At CA\$75,000 level of income, the proposed tax rate reductions would rank Alberta, Ontario, and British Columbia among the 15 jurisdictions with the lowest combined marginal tax rates. Five provinces would still rank among the ten jurisdictions with the highest marginal tax rates, but the reform would be a substantial improvement on the current personal income tax system.

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8 There is a risk that some provinces would hike their own tax rates in response to federal tax changes and wipe out some or all of the gains in tax competitiveness.

Figure 4: Proposed top combined statutory marginal income tax rate, Canadian provinces and US states

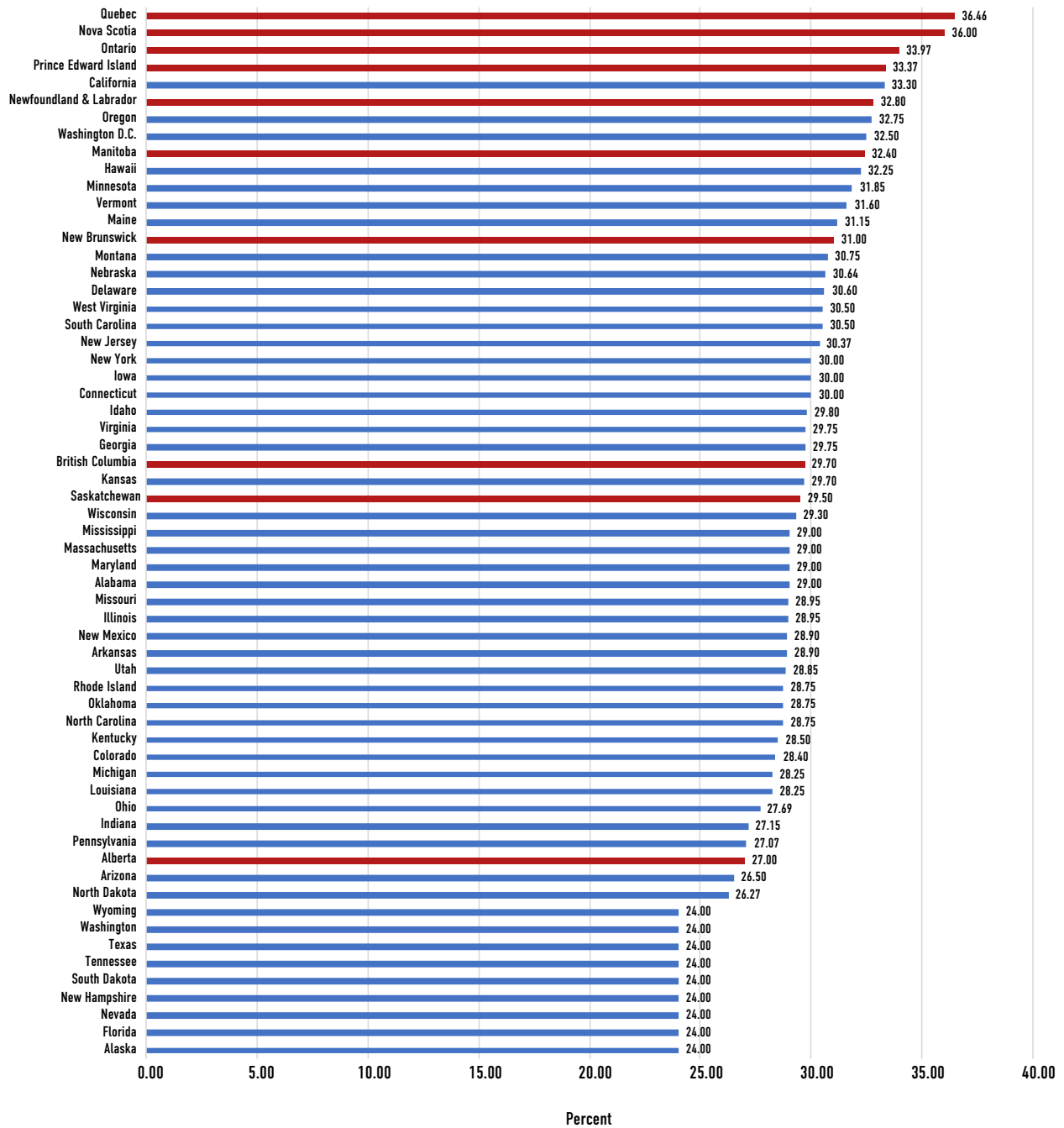


Notes:

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- 2) For US states, local income taxes are excluded.

Sources: Canada Revenue Agency (2023); Durante (2022); Revenu Québec (2023); Vermeer (2023); authors' calculations.

**Figure 5: Proposed combined statutory marginal income tax rate at CA\$150,000, Canadian provinces and US states**

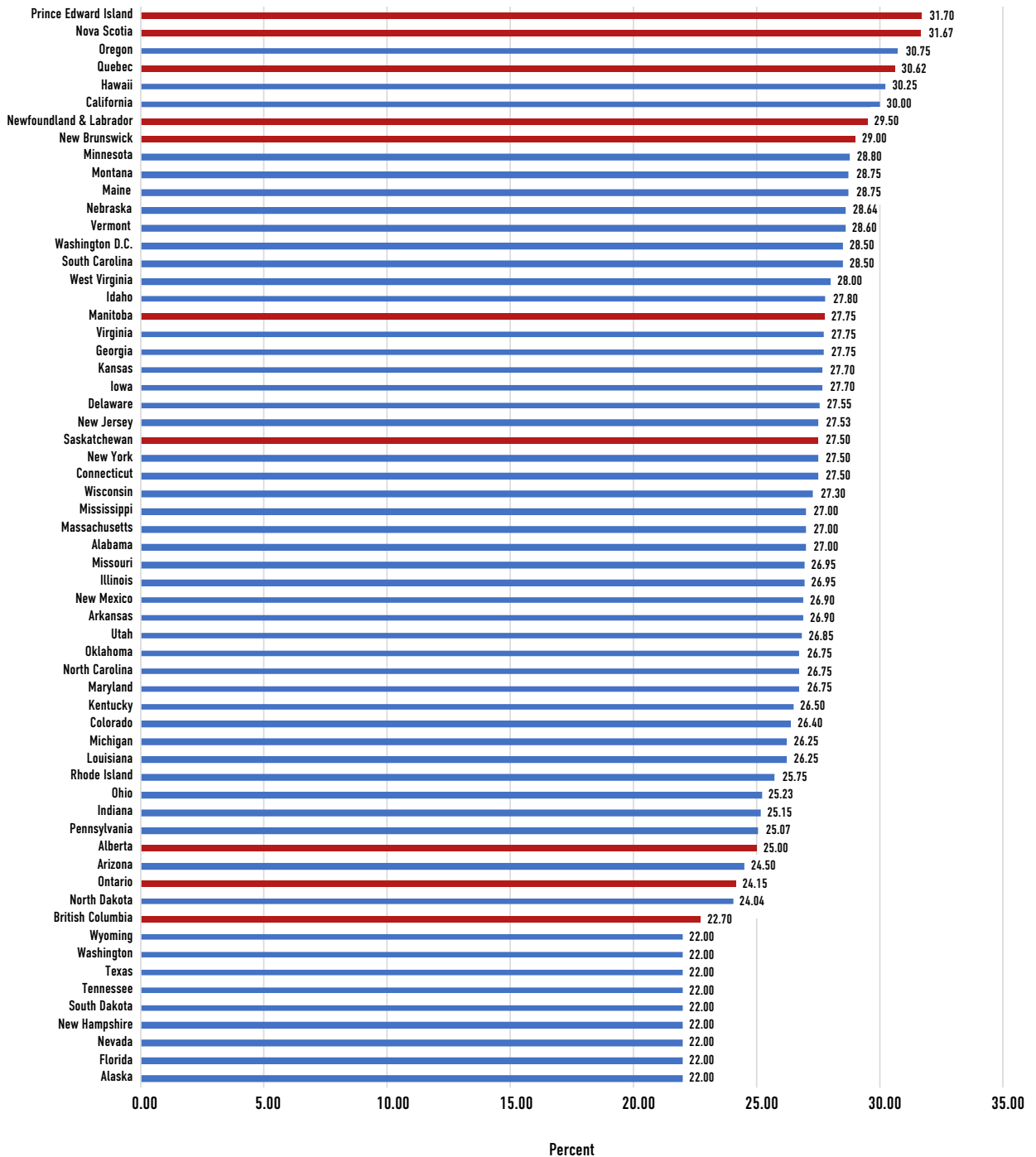


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Sources: Canada Revenue Agency (2023); Durante (2022); Revenu Québec (2023); TD Economics (2023); Vermeer (2023); authors' calculations.

**Figure 6: Proposed combined statutory marginal income tax rate at CA\$75,000, Canadian provinces and US states**



Notes:

- 1) Personal income tax rates include surtaxes where applicable. Quebec’s tax rate is adjusted for the federal abatement.
- 2) For US states, local income taxes are excluded.
- 3) The 2023 exchange rate for converting Canadian dollars to US dollars is 1.3475 (average quarterly projection, TD Economics, 2023). At this rate, CA\$75,000 is equivalent to US\$55,659.

Sources: Canada Revenue Agency (2023); Durante (2022); Revenu Québec (2023); TD Economics (2023); Vermeer (2023); authors’ calculations.



## Conclusion

Canada's tax system is characterized by increasing complexity, various inefficient tax expenditures, and waning competitiveness, and is in serious need of reform. A broad-based reduction in marginal tax rates would improve economic incentives and tax efficiency, enhance growth, simplify the tax system, and increase Canadians' living standards. Although there would be fiscal challenges in implementing such a reform, the federal government could remove 49 different tax credits and deductions, for savings of approximately \$32.1 billion with which to mitigate the vast majority of revenue losses associated with any tax reduction measures.

The revenue from the tax expenditures we identify for elimination and a modest reduction in government spending would give the federal government an opportunity to remove the three middle income tax rates of 20.5 percent, 26.0 percent, and 29.0 percent. Moreover, the government could reduce the top marginal PIT rate from 33.0 to 29.0 percent and leave the bracket's current income threshold as is. With these tax changes, Canadian provinces would become significantly more tax competitive with their counterparts in the United States. This would provide a much-needed boost to the Canadian economy by improving incentives to work, save, and invest.

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